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Topics in UK Utility Retail

by

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Topics in UK utility retail – Agenda

- Industry overview
- Key features of UK competitive market
- Market review

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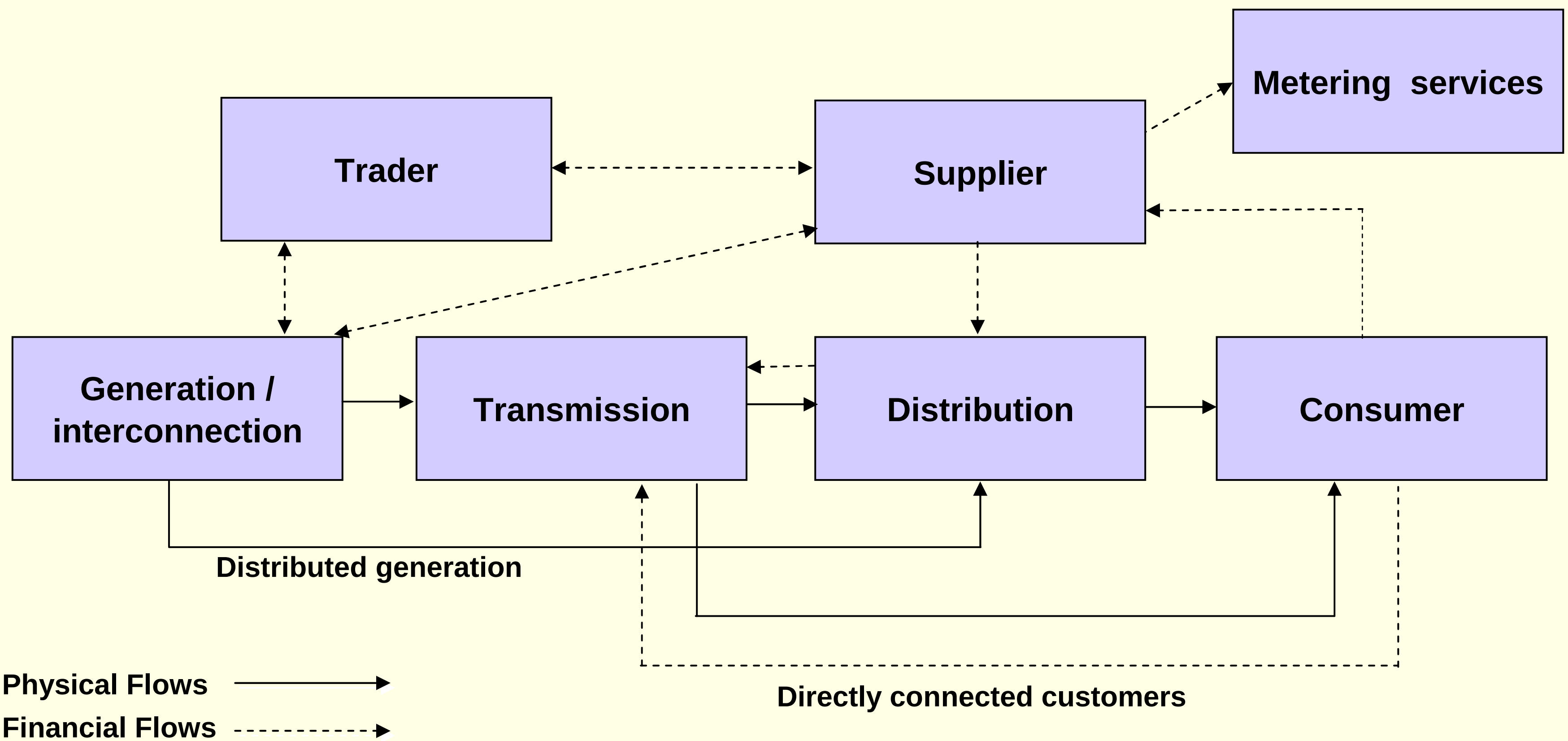
Key stats on UK system

- Total system capacity of 80,000 MW and peak demand of 57,000 MW
- 29 million total customers consuming 365,000 GWh of electricity
- Natural gas makes up largest share of electricity supplied at around 35-40%
- Office of Gas and Electricity Markets (Ofgem) regulates industry by granting licenses
- Monopoly businesses of T&D are regulated through price controls (reset every 4-5 years)
- Generation and retail supply have been deregulated and operate in fully competitive markets

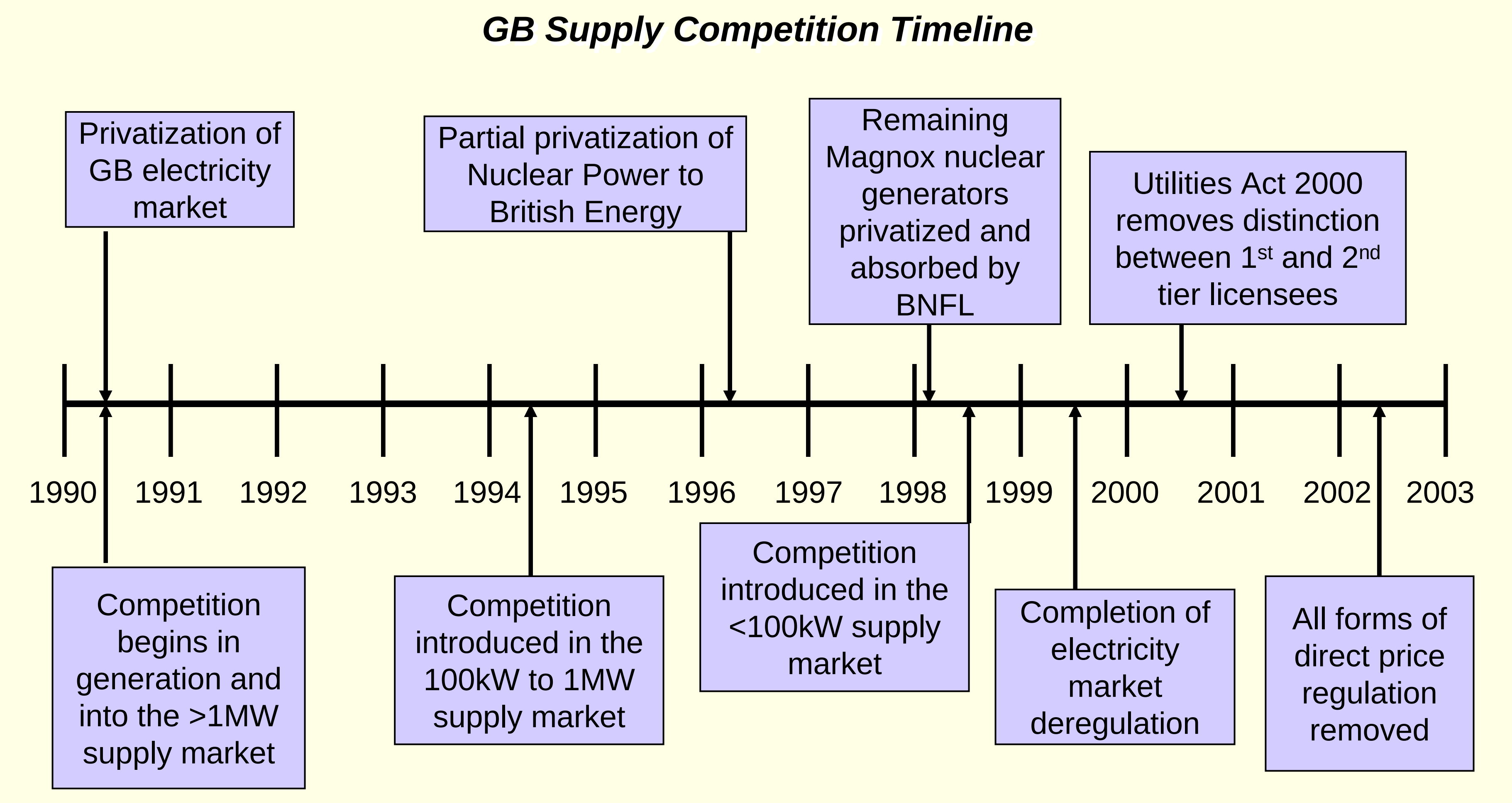
Today’s electric industry structure

Electricity structure in GB



Source: Ofgem

Timeline to supply competition



Source: Datamonitor

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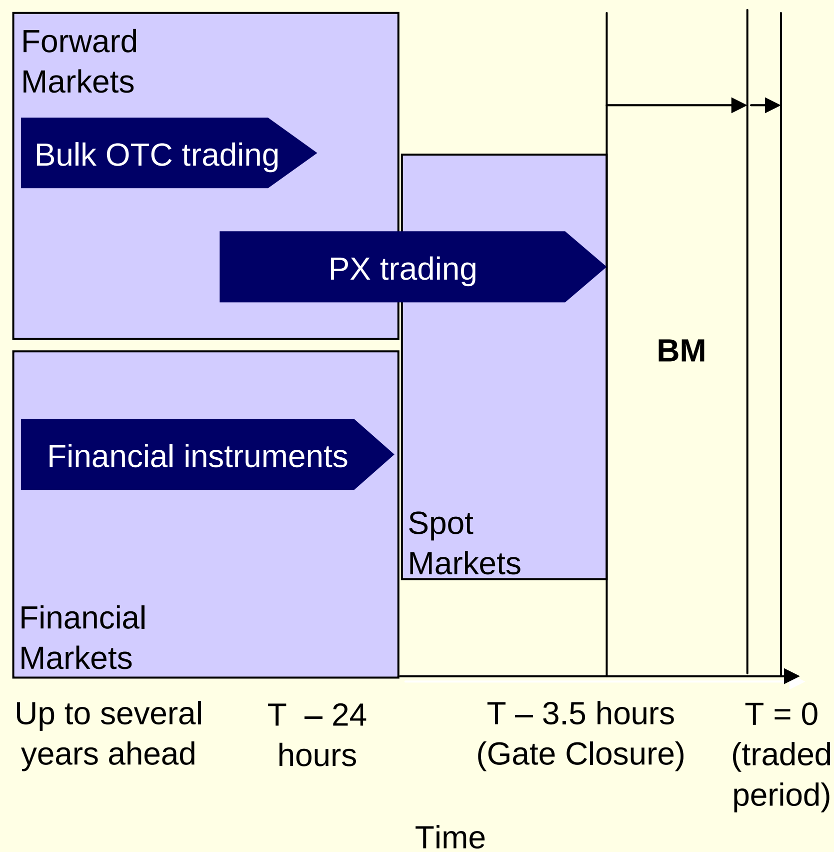
What obligations do electricity suppliers have to serve customers?

- Any company holding electricity supply license can sell electricity
- Suppliers are obligated to meet Standard License Conditions:
  - There is no duty to supply, but licensees have a duty to offer terms on request
  - Cross-subsidies of any kind are prohibited
  - Suppliers can offer different contractual terms across customer types or areas
- T&D companies are also obliged to meet Standard License Conditions:
  - Provide access to system & certain ancillary services on a non-discriminatory basis
  - Distributors are required to maintain full managerial and operational independence from any of their affiliates and related undertakings
- Suppliers can supply customers nationwide using another company's distribution network and paying them for use of the system
- Suppliers who are authorized to supply customers must meet all "reasonable" demands made by customers

How is electricity procured?

- New Energy Trading Arrangements (NETA) replaced the Pool in 03/01
- Most of the UK's power is traded through bilateral contracts ahead of time
- Power is also traded on forward and futures markets and through PXs
- NGC operates a Balancing Mechanism (BM) to ensure system security
  - about 2% of power goes through the BM
  - generators out of balance if cannot provide contracted power or generate too much
  - suppliers out out of balance if they consume more than contracted or consume too little
- Due to NETA (among other factors) baseload prices have fallen by 19% and peak prices by 27%

Traded markets under NETA



Source: Ofgem

How are tariffs set in the UK?

- All forms of direct electricity and gas retail price regulation removed in 2002
- Two-tier pattern of prices has emerged in residential market, where incumbents:
  - maintain prices to existing customers
  - lower prices to attract new customers
- No lock-in period with residential customers
- Suppliers are beginning to offer more innovative tariffs
- I&C customer rates tend to reflect characteristics of the business

Examples of more innovative tariffs

Tariff innovation	Examples
Lifestyle tariffs	BG offering energy at entirely variable rates & no standing charge
Social tariffs	Powergen's "staywarm" tariff targeting those over 60 years of age
Green tariffs	Examples include npower's "Juice" tariff with Greenpeace
Price caps	SP offering capped tariffs to all first tier (in-area) customers
Added features	BG provides free bill payment cover in case of accidental death
Payment options	Most suppliers offer standard credit, direct debit and prepayment options

Source: Datamonior

What does Ofgem do to assist disadvantaged customers?

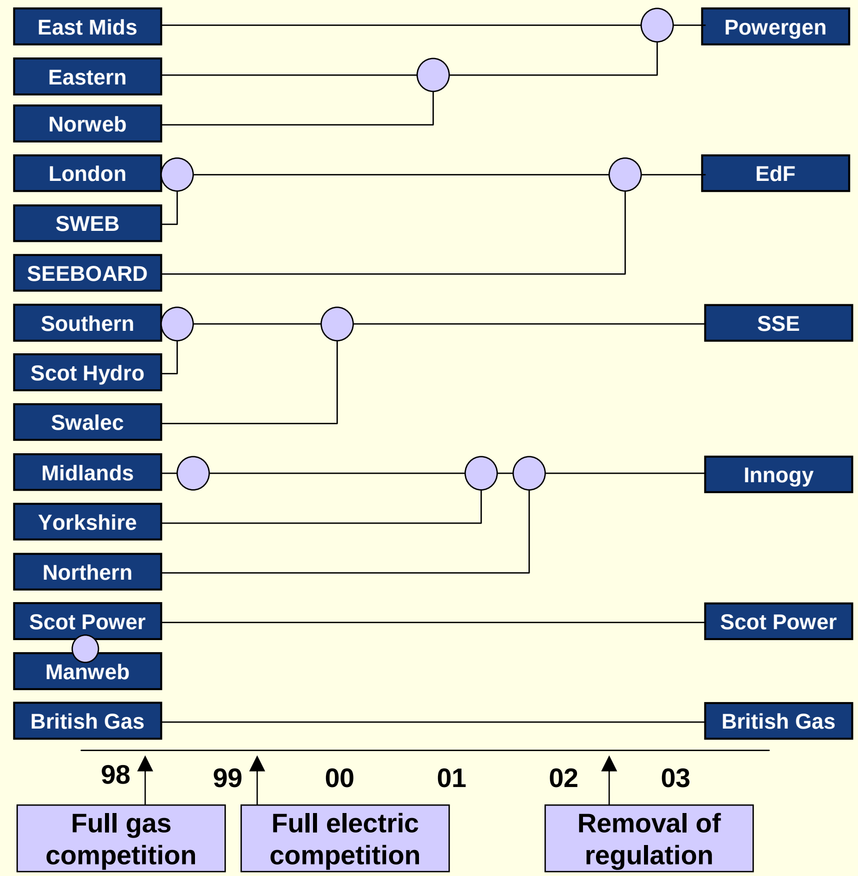
Energy efficiency advice	**Working with industry participants to develop best practice guidelines for the industry on money-saving energy efficiency advice**
Encourage older people to switch	**Ofgem and Age Concern are working on a joint campaign to encourage more older people to switch to more competitive suppliers**
Help prepayment meter customers	**Working with industry participants and energywatch to improve the information suppliers give to customers about meters and ability to pay**
Improve debt prevention and management	**Working with energywatch to identify and promote good practice in debt prevention**
Promote competition	**Working to ensure that people whose first language is not English are aware of the benefits of competition**

Source: Ofgem

What are key competitive issues in the UK electricity market?

- Delivering a single electricity market across the whole of GB
- Introducing competition into the metering & connections markets
- Delivering environmental policy compatible with competitive energy markets
- Sustaining competitive retail supply
  - Consolidation in the retail energy market
  - Misselling / erroneous transfers of customers to new suppliers

Consolidation of Retail Supply Market



Source: E&Y

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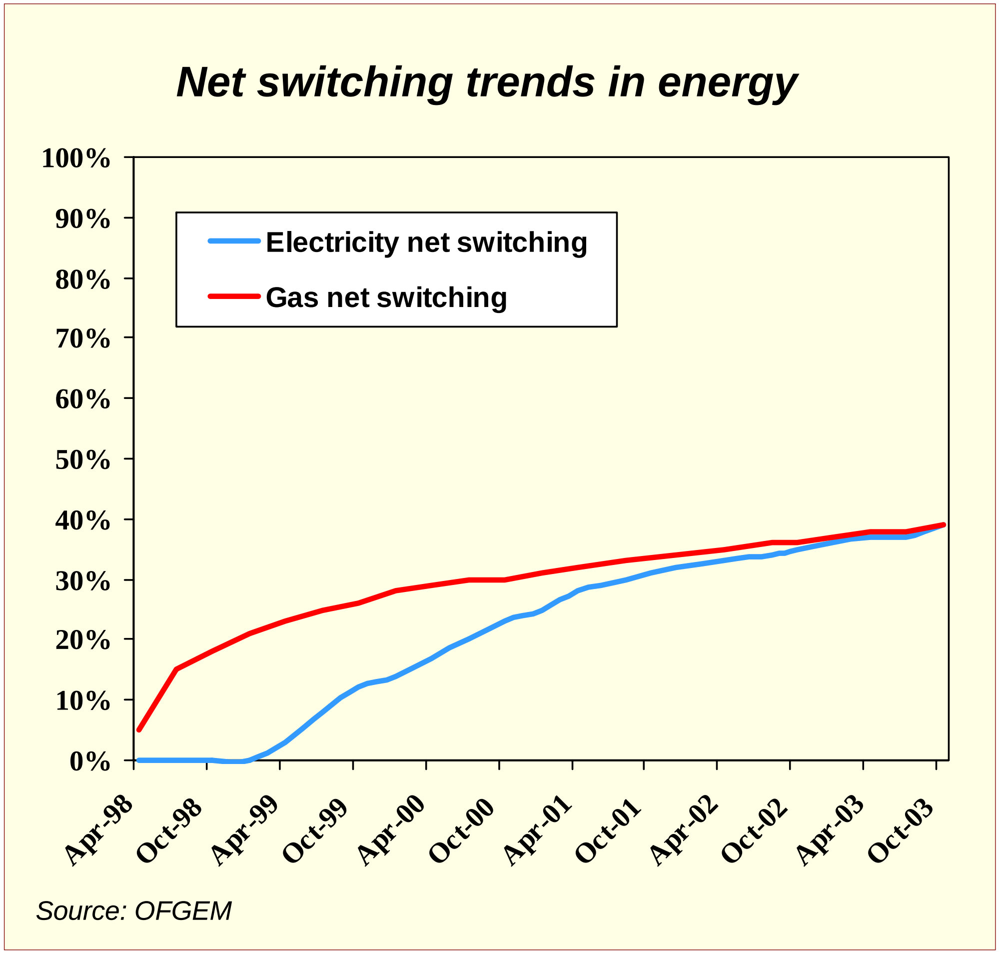
Market review

Market review topics

Customer switching

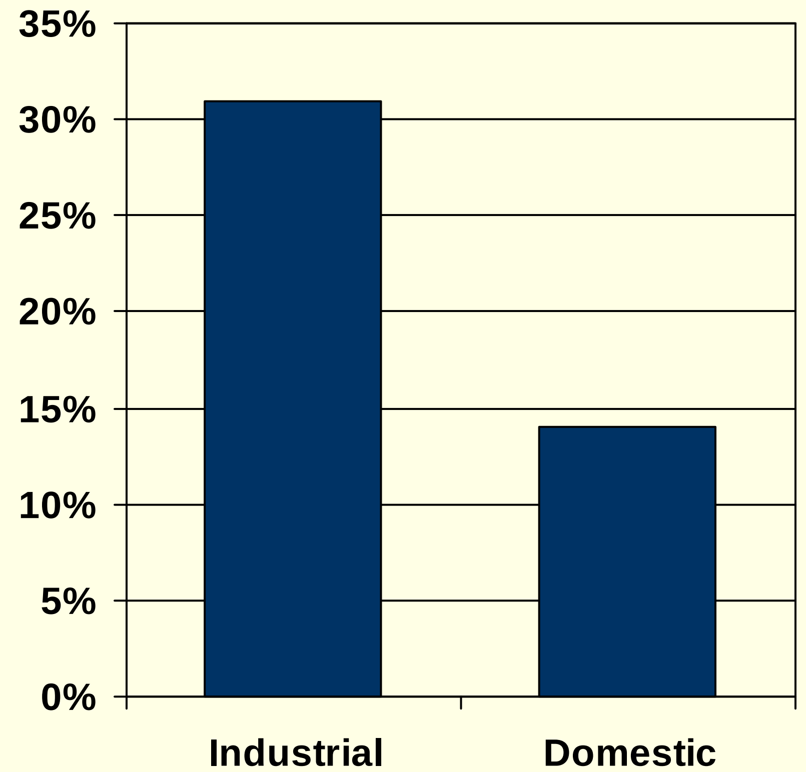
- Over 80% of customers with a demand of 1 MW are being served by a non-local supplier
- More than half of all customers with a demand of 100 kW to 1 MW are supplied by non-local supplier
- Around half of residential customers have switched suppliers at least once
- Non-incumbent new entrants have have yet to gain a foot hold in serving residential customers (with less than 5% of the total market)



Retail prices

- Average annual residential prices have fallen 14% over the last five years in real terms
- Average annual industrial prices have fallen 31% over the last five years in real terms
- Difference in price paid by largest and smallest I&C consumers is narrowing:
    - Largest I&C users have seen real terms price falls of 29% over the last ten years
    - Smallest I&C users have seen real terms price falls of 38% over the last ten years

Real decline in average annual electricity prices over past 5 years



Source: DTI

Customer acquisition channels

- Residential customer acquisition channels:
  - Doorstepping is consistently the primary point of contact
  - Doorstepping also has the best conversion rate of contact to contract
  - Contacted about 1.7 times per year on average to switch suppliers
- I&C customers typically acquired through a formal tendering process

% type of sales contact in UK, 2000-02

	2000	2001	2002
Doorstep salesperson	62%	61%	61%
Leaflet through the door	39%	33%	34%
Telesales	22%	25%	27%
TV advert	28%	25%	24%
Street /shopping centre	14%	18%	20%
Contacted retailer	5%	5%	5%
None	12%	12%	12%

Source: Datamonitor

Mass market retail strategies

Current supplier product and geographic market positioning